and ubiquitous points of presence (POPs)[9] to find the most efficient way to route calls (Direct Testimony of Steven W. Hooper (Hooper), p. 22). The settlement commits applicants to deploy call forwarding and call redirection as roaming services within five years. Call redirection will use the network intelligence to route a call to a cellular customer without first going to the customer's home service area. Applicants will also "work closely" to use ISDN to signal between the wired and wireless networks to enhance roaming capability. (Settlement, par. 32(a).)

- McCaw's cellular customers will also benefit from improved fraud control. (Chakrin, pp. 30-31.) The settlement explains that this will be accomplished through sharing of AT&T's and McCaw's databases. (Settlement, par. 32(a).)

- McCaw's customers' convenience will increase due to their access to AT&T's marketing and distribution system. (Chakrin, p. 34.) The settlement provides that within five years customer contact representatives will be available to McCaw customers 24 hours a day, seven days a week (Settlement, par. 32(b)). McCaw will be able to draw on AT&T's experience to give McCaw's customers greater billing options and to promote customer-focused billing. AT&T will also share its methods of identifying customer dissatisfaction and making positive changes to help the customer.

9 A POP is the interface between the IEC and the network of the local exchange company (LEC). Originating calls between LATAs are handed off at the POP from the local system to the IEC's long distance network; terminating interLATA calls are transferred at the POP from the IEC to the LEC for completion. IECs usually have one POP in each LATA in which they do business.

- Improved efficiencies will make cellular service available to a wider segment of the population. (Hooper, pp. 23-24.)

- AT&T has over 150 microwave sites, which under the settlement (par. 32(a)) McCaw may use as cellular sites to expand service and improve quality without raising the usual business and environmental problems of new cellular sites. (Hooper, p. 24.) McCaw's system capacity will also be expanded by accelerating incorporation of Signalling System 7 (SS7) into the cellular system. (Settlement, par. 32(a).)

- Applicants commit to make at least $32.5 million in capital investments over two years in California to improve McCaw's cellular service. Applicants will supply reports on their capital investments to DRA and the Commission Advisory and Compliance Division (CACD) for five years. (Settlement, par. 30).

Applicants identify the following long-term benefits of the merger:

- Customer service will improve, manifested in a lower percentage of dropped calls, improved sound quality, reduced cross-talk and interference, and improved transferring of calls between wireless and wired systems. (Chakrin, pp. 31-33.)

- McCaw's access to AT&T's Bell Labs will lead to faster development of new technologies and research and development of capacity expansion, radio frequency propagation characteristics, speech recognition, and systems integration. (Hooper, p. 24; Settlement par. 32(c).)

- The merged company will use AT&T systems and expertise to comply with the Commission's WMDVBE program (Settlement, par. 34), resulting in a higher level of procurement from WMDVBEs (Chakrin, p. 35).[10]

- The merger will further the development of universal number service for McCaw's customers. (Hooper, p. 24.)

- If the Commission imposes a surcharge to support Universal Lifeline Telephone Service (ULTS) on cellular customers, McCaw's customers will make a substantial contribution to maintaining universal service in California. (Chakrin, p. 35.)

- McCaw will implement digital technology where cost-effective over the next five years. (Settlement, par. 32(a).)

No party has disputed this assessment of the net benefits of the proposed merger, and we accept that the proposed merger will produce the listed net benefits in the short and long term.

In light of the Commission's approach to regulating these types of telecommunications utilities, the ratemaking method for passing on these benefits is competitive pressure on prices, according to applicants. The Commission has allowed a substantial level of competition in cellular, paging, radiotelephone, and interexchange toll markets, and competitive mechanisms are therefore the most appropriate ways of ensuring that customers receive the short- and long-term benefits.

We agree that competitive price pressures and service competition are the appropriate regulatory mechanisms to use to assure that the net benefits of the proposed merger are passed on to ratepayers. (See Decision (D.) 90-06-025, 36 CPUC 2d 464, 470.) We have used competitive mechanisms to a great degree in our

10 The settlement refers to the "WMBE" program. The current version of General Order (GO) 156 expands the eligible categories to included disabled veterans.

regulation of these industries, and there is considerable industrywide evidence that competition, in the industry segments where it is present, has produced lower prices and improved service. It would be illogical to reimpose cost of service ratemaking in these areas merely to ensure that merger benefits are transferred to ratepayers.

IV. Effect on Competition

Section 854(b)(2) requires the Commission to find that the proposal does "not adversely affect competition. In making this finding, the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result."

Complying with the statute, we requested and received a very thorough and helpful analysis from the AG. Our discussion will follow the broad outline of the AG's opinion, and we will incorporate the arguments of other parties into this outline. The effect of the proposed merger on competition was also the focus of the comments contesting the settlement and of Telesis' testimony.

For purposes of antitrust analysis, mergers are classified into three large groupings: Horizontal mergers involve firms that compete in the same market; for obvious reasons, these mergers draw the closest scrutiny for anticompetitive implications. Vertical mergers combine a firm and one of its suppliers or customers, such as a steel company and an iron mining firm. Conglomerate mergers are neither primarily horizontal or vertical, and are further subdivided into product extension, market extension, or pure conglomerate categories. (See Direct Testimony of John W. Mayo (Mayo), pp. 4-5.) It appears that the AT&T-McCaw merger is primarily a product extension conglomerate merger, with some vertical and horizontal aspects.

The AG's analysis follows a general approach commonly used in the antitrust arena to examine the potential for competitive harm resulting from a merger. One purpose of this analysis is to determine the likelihood that a proposed merger will give the surviving entity increased market power in the relevant market. Market power is generally defined as the ability of a single firm or a few firms to exert some degree of control over prices or output in the designated market. The ability of a strong competitor to exercise market power is influenced by several factors, including the structure of the market, the availability of near-substitutes for the product, ease of entry into the market, and expected developments in the market.

The analysis begins by identifying the relevant product markets affected by the merger. Definition of the product market considers products or services that are reasonably interchangeable and weighs the horizontal and vertical implications in the identified product market. The geographic scope of the market, the areas in which the sellers compete and in which buyers can practicably turn for supply, must then be identified. (See Opinion of the Attorney General on Competitive Effects of the Proposed Merger of American Telephone & Telegraph Company and McCaw Cellular Communications, Inc. (AG's Op.), pp. 11-12.) The analysis also considers the market structure, market concentration, barriers to entry, prospects for anticompetitive activity, and the possibilities for efficiencies. (See Mayo, pp. 6-11.)

Four relevant markets are affected by this merger. We will address each of these markets in turn and discuss whether the merger will give AT&T/McCaw increased market power or have other anticompetitive effects.

A. Interexchange Telephone Service

The market for interexchange (long distance) telephone service affects both AT&T and McCaw. The AG defines this market's product as "interexchange services that are resold or are available for resale within the United States." (AG's Op., p. 13; see Mayo, p. 16.) More than a decade after divestiture, AT&T remains the largest IEC in the country with some 60% of the market. This market is dominated by three major carriers--AT&T, MCI Telecommunications Corporation (MCI), and Sprint Communications Company, L.P. (Sprint)--with lesser participation by a group of about seven national companies. However, there are also hundreds of resellers competing in this market. About 190 IECs have certificates of public convenience and necessity (CPCNs) authorizing them to operate in California. Reselling long distance service is the principal business of two of the McCaw companies involved in this transaction, California InterCall, Inc. and Cellular Long Distance Company.

Because both AT&T and McCaw sell long distance services within the United States, this element of the merger has horizontal aspects. Because of AT&T's dominant position in the market, the merger may also have vertical implications affecting the related markets for cellular services.

Telesis contends that AT&T has market power in the interexchange market, and that the merger will increase AT&T's ability to engage in anticompetitive behavior, such as price discrimination, price following, and improper bundling of products or services. Much of Telesis' argument concerns the potential for vertical anticompetitive activity by the merged firm.

1. **Market Power**

Telesis asserts that AT&T maintains market power in the market for interexchange long distance services, and that power will endure because AT&T dominates the two other major facilities-based carriers, MCI and Sprint, in terms of providing long distance services to cellular customers, wire-based customers, and small businesses. Telesis presents studies supporting its argument that the market is an oligopoly, with MCI and Sprint content to follow AT&T's price leadership. If vertical integration of wireless and long distance services of the sort proposed here is a precondition to competition in wireless markets, Telesis contends that the wireless market will remain concentrated even after the introduction of new wireless technologies. The ability to offer both wireless and long distance services becomes, in essence, a requirement for entry into the California wireless market. Few, if any, of the numerous firms that are expected to enter the local wireless market in the next few years would have the ability to acquire or build a long distance system rivaling AT&T's. According to Telesis, the lack of effective competition for combined wireless and long distance services will allow AT&T/McCaw to charge uncompetitive prices and reap higher-than-competitive profits. Telesis' subsidiary Pacific Bell and other RBOCs could offer effective competition, but they are prohibited from entering the interexchange market by the restrictions of the Modified Final Judgment (MFJ), which set the terms for the breakup of the old AT&T. (See Telesis' Comments on the Proposed Settlement Between Applicants AT&T and McCaw and the Division of Ratepayer Advocates (Telesis' Comments), pp. 13-15.)

Telesis finds support for its conclusion from data indicating an extreme concentration in the market for residential and cellular long distance services. Application of a standard measure of industry concentration, the Hirshman-Herfindahl index (HHI), to this market produces an index of over 4,000. By the standards of the United States Department of Justice and the Federal Trade Commission, highly concentrated industries are those with indices of 1,800 or more. (Prepared Testimony of Professor Jerry A. Hausman (Hausman), p. 26.)

Telesis' conclusion conflicts with our previous findings in our review of a request for pricing flexibility by AT&T's regulated subsidiary, AT&T Communications of California, Inc. (AT&T-C). In D.93-02-010, we granted that request on the ground that "effective competition" existed in the market for intrastate interLATA communications. In reaching this conclusion, we evaluated eight criteria: the relevant market, market share, earnings, facilities ownership, market entry and exit, individual carrier's size and growth, equal access, and customer satisfaction. Although the geographic market we considered (California) is different from the national market Telesis studied, the contradiction between Telesis' conclusions and ours is striking. We think two primary considerations explain this discrepancy.

First, focusing on the current concentration in this industry, as Telesis' use of the HHI calculation does, ignores the dynamic nature of telecommunications. While it may be true that AT&T has about 60% of this market, it is also true that only about a decade ago it had nearly 100% of the market.[11] The changes in the industry structure have produced explosive growth, so that even firms with static market shares would have recorded significant growth. More important, the dynamism of this industry promises to increase in the future. Using a measure like the HHI to produce a static snapshot of the industry fails to capture the trends in this industry. At least in California, we see a trend of increasing competition in interexchange telecommunications, a trend that will by no means be thwarted by this merger.

Second, we disagree with Telesis' conclusion that high entry barriers prevent increased competition in this market. The entry barriers for resellers are very low; we now require a showing of only $25,000 in financial assets from applicants for a CPCN as a

11 Similar declines in market share have occurred in the California portion of the interexchange market. In D.93-02-010, for example, we found that AT&T-C's two main competitors increased market share, measured in a variety of ways, while AT&T-C's share decreased. In four segments of the interLATA market, AT&T-C showed consistent, and sometimes dramatic, loss of market share. (Id., slip op. at 31-32.)

market power it may still possess in this market to control prices or to inhibit the entry of new competitors into the cellular market. To the extent that Telesis is correct that a new product market for integrated cellular services is emerging, we have little doubt that formidable competitors, perhaps including Telesis itself, will soon appear.

2. Price Discrimination

Telesis accuses AT&T of engaging in a form of price discrimination in long distance services: AT&T charges the same rates for long distance calls placed over conventional telephones as it charges for calls made over cellular facilities, even though calls using the cellular network have lower costs. According to Telesis, a long distance call originating from a cellular phone can be transferred directly from the cellular mobile telephone switching office (MTSO) to AT&T's POP in the LATA. By avoiding much of the public switched network, this routing allows AT&T to avoid paying the LEC the interstate access charge of about 2.3 cents per minute (which for conventional calls is incurred at both the originating and terminating ends); AT&T must pay only a transport charge of about 0.6 cents per minute. Telesis calculates that AT&T's access charges are 47% lower for a cellular long distance call than for a comparable landline call, and 74% lower if the call terminates to another cellular phone; overall costs are about 30% less, or about 61% less for cellular-to-cellular calls. (Hausman, pp. 8-9.)

By charging identical rates for calls with very different costs, AT&T discriminates against cellular customers, according to Telesis. Telesis sees this practice as evidence of AT&T's market power, exercised in this case in implicit collusion with MCI and Sprint. Although either MCI or Sprint could undercut AT&T's prices for cellular long distance calls, neither has, a fact that Telesis attributes to the lack of competition in this market.

We find neither improper price discrimination nor evidence of market power in the facts and behavior Telesis refers to. Our reaction to Telesis' points is tempered by several considerations. As Telesis acknowledges, this is not the type of price discrimination that is prohibited by state and federal antitrust laws (Hausman, p. 4, n.1.), and in this respect the laws are rational--this sort of behavior does not raise the same anitcompetitive concerns as unlawful price discrimination. Focusing solely on access costs ignores the possibility that other costs, such as losses due to fraud, may be higher for cellular customers, so that the overall cost of cellular long distance service may be close to the cost of landline service. (Mayo Reb., p. 2.) (Telesis' estimates of overall cost differences take into account at least some of these other costs.) More fundamentally, even in highly competitive industries it is commonplace to charge a uniform price to customers who cause the seller to incur very different levels of cost. Applicants' witness offers two everyday examples of this:

> "[B]oth my wife and I pay the same price for the local pizza buffet, yet typically impose very different costs on the supplier. Similarly, furniture stores often provide free delivery to customers within, say, 100 miles. In this case, the price of a dining room table may be the same for two customers, yet the costs to the furniture store associated with the sale to the customer who lives, say, 95 miles from the store will be different than for the customer who loads the table in the back of his pickup truck for the short trip home." (Mayo Reb., pp. 6-7.)

Other examples abound, and we agree that a certain amount of price averaging is the rule even in competitive industries.

At some point, however, a seller makes a business decision to identify a group of customers with particular cost characteristics and to charge them a special (higher or lower) price more in line with those characteristics. This identification of customer groups often comes in response to competitive pressures or to take advantage of market opportunities. A pertinent example of this, which we discuss later, is McCaw's decision to charge certain types of cellular long distance calls in its Florida service areas as local calls. To the extent that the cost advantages that Telesis identifies exist for cellular long distance services, we agree with Telesis that the solution is to increase competitive pressures or market opportunities.

Although Telesis' specific suggestion--increasing competition for interexchange services by lifting the restrictions of the MFJ--lies beyond our jurisdiction, we note that proposals to loosen the restrictions on the RBOCs are pending before both Congress and the federal court overseeing the MFJ. For our part, we have supported several of the bills that would permit RBOCs to compete in the interexchange market. We have also recently created a potential competitor to this portion of a combined AT&T/McCaw's operations when we authorized the spinoff of PacTel Corporation, which includes Telesis' wireline operations, from Pacific Bell, the RBOC. (D.93-11-011, reh. den'd D.94-03-036.) The new wireless company, renamed AirTouch Communications, will be free to offer interexchange services, if it chooses.

We also conclude that permitting the applicants to take advantage of market opportunities that may arise as a result of the merger (absent other competitive objections) will soon produce price reductions corresponding to any lower costs associated with cellular long distance calling. By conditioning our approval of the merger on the implementation of equal access for McCaw's cellular customers (discussed in the following section), we may in the process create market opportunities for AT&T's competitors. Telesis noted that neither of AT&T's primary competitors, MCI and Sprint, tried to increase market share by offering cellular customers long distance rates reflecting the lower costs of providing service to those customers. Telesis sees this as proof of AT&T's market power, but we note that McCaw's customers, like other customers served by non-RBOC cellular providers, currently have no ability to choose the services of a long distance company; McCaw purchases bulk services from AT&T and resells the long distance services to its customers. In these circumstances, it is not surprising that MCI and Sprint did not woo a market they could not win. By requiring the merged company to implement equal access to IECs for its cellular customers, we will create the market opportunities that may lead other IECs to compete more vigorously for these customers.

3. Equal Access

One of the controversies raised by the proposed merger was the prospect that McCaw's cellular customers would be forced to use AT&T for their carrier of interLATA calls. In response to this concern, the settlement includes provisions to assure that McCaw's customers would have equal access to the IEC of their choice.[12]

Under the settlement, applicants have agreed to complete implementation of equal access for McCaw's existing California customers within 24 months of the date of the merger. This issue is also currently before the Federal Communications Commission (FCC), and the applicants' implementation will comply with any order the FCC issues on this topic. If the FCC fails to act within six months of the date of the merger, applicants will proceed to implement equal access on the terms set forth in the settlement. Customers will be notified of their right to equal access and their ability to chose a different IEC, and customers' presubscription to IECs (which automatically assigns interLATA calls to the chosen IEC without requiring the customer to dial extra digits) will be

12 Strictly speaking, "equal access" refers to the arrangements necessary to give IEC's fair access to the LEC's or cellular company's facilities so that the customer may receive convenient long distance service from any of the many IECs serving the area.

honored for calls terminating outside of McCaw's California utilities' cellular calling area. Expansion of this calling area will be requested by advice letter, and any such expansion will be limited by the boundaries of the competing cellular wholesaler. Applicants will report on the progress of equal access to DRA and CACD every six months. (Settlement, par. 24, 25.)

Telesis contends that the settlement does not adequately define equal access, and thus applicants' commitment is hollow. (See Telesis' Comments, pp. 8-11.) Telesis reminds us that the concept of equal access was created by the MFJ, and the meaning is determined by the obligations of the RBOCs, including Pacific Bell, under the MFJ. But the settlement specifically distinguishes its requirements of equal access from the RBOCs' obligations under the MFJ. Telesis lists several of the RBOCs' equal access obligations that are absent from the settlement.

Telesis also questions why applicants' implementation of equal access will take up to two years, as the settlement permits. Telesis thinks that this period will be extremely important for developing competition in wireless markets because of the FCC's scheduled auction in May 1994 of personal communications system (PCS) frequencies and because new wireless technologies promise to allow much greater competition during this period. Delaying equal access for two years could give applicants an unwarranted and anticompetitive jump on competitors by tying large numbers of customers to AT&T, to the detriment of other IECs who want to serve the wireless market.

The essential ingredient to a competitive market is choice, and equal access is crucial to providing customers with the convenient ability to choose an IEC. We have previously stressed the importance of equal access as a benchmark for determining the competitiveness of the interLATA market, and our conclusion that the intrastate interLATA market was effectively competitive is grounded at least in part in the fact that over 97% of the population in this market has equal access. (D.93-02-010, slip op. at 45-46.)

Unfortunately, equal access is generally not available to cellular customers served by non-RBOC wholesalers. The settlement improves this situation somewhat by committing applicants to provide equal access to McCaw's cellular customers. The settlement's provisions may not describe the optimum arrangement, but we conclude that the settlement articulates acceptable requirements for equal access.

We further conclude that applicants' commitment to equal access will increase competition for the long distance business of McCaw's cellular customers. Any concern that AT&T will use its purchase of McCaw to compel McCaw's cellular customers to subscribe to AT&T's long distance service can be easily dismissed. As we have mentioned, McCaw currently purchases long distance services from AT&T in bulk and resells the service to its customers; at present all long distance calls originating from McCaw's cellular customers are in fact carried by AT&T. As equal access is implemented, McCaw's cellular customers will acquire the ability to use other long distance carriers, an ability they do not presently have. Thus, one of the merger's effects on the California interexchange market will be to increase competition by breaking AT&T's current status as the sole long distance provider for McCaw's cellular customers.

We are sympathetic to Telesis' concern that delaying implementation of equal access for up to two years could disadvantage some of AT&T's competitors. We will direct applicants to complete their implementation of equal access as quickly as practicable, and we instruct CACD, as it reviews the periodic reports, required by the settlement, on the implementation of equal access, to bring to our immediate attention any indication that applicants are delaying implementation of equal access for competitive reasons.

4. Bundling

Telesis is concerned that the merger presents an opportunity for applicants to offer bundled local cellular and long distance service before any other competitor can offer comparable services. Getting this sort of jump on the competition could discourage other entities from attempting to enter this market, to the detriment of competition and, ultimately, consumers. Telesis also fears that bundling will permit AT&T to use its market power in interexchange services to make competitive inroads in the mobile telecommunications market. (Telesis' Comments, pp. 11-13.)

In a similar vein, CAA accuses applicants of bundling cellular equipment and service, in violation of D.89-07-019 (32 CPUC 2d 271) and Business and Professions Code § 17026.1.[13] According to CAA, to buy cellular phones at advertised discounts, customers are required to sign up for service for a year at rates that may exceed ordinary retail off-peak rates.

The subject of bundling has been addressed by both the Legislature and this Commission. Section 352 prohibits utilities from selling two or more of their products in combination for a price different from the sum of the rates for the individual services. As CAA points out, Business and Professions Code § 17026.1 bars the bundling of cellular equipment and service. We have prohibited the practice of requiring the customer to subscribe to cellular service at tariffed rates as a condition for receiving special rates or discounts on cellular equipment. We have also prohibited the bundling of tariffed and unregulated

13 Business and Professions Code § 17026.1 reinforces a cellular customer's right to subscribe to a cellular service provider other than the provider for whom the retailer is an agent. The section also reaffirms the Commission's prohibition on the bundling of cellular service and equipment. Section 17026.1 took effect January 1, 1994.

services. (Cellular Resellers Association Inc. v. PacTel Cellular, et al. [D.89-07-019] 32 CPUC 2d 271, 280, 282; D.90-10-047, modifying D.90-06-025, 36 CPUC 2d 464.) More recently, we have specifically forbidden AT&T-C to bundle services at less than the aggregate prices for the composite individual services. (D.93-02-010, slip op. at 62-64.) We have also held that § 453(a) bars utilities from tying the provision of one type of service to the purchase of another service. (Id. at 64.)

Under the settlement, AT&T and McCaw agree to abide by the Commission's and the PU Code's provisions on bundling (although they reserve their rights to seek elimination of bundling restrictions through normal Commission procedures and to pursue deviations from these restrictions through the process stated in GO 96-A). (Settlement, par. 27-28.)

Because of these restrictions, it seems unnecessary to elaborate further on the bundling issue at this time. The restrictions are in place and are adequate to prevent the competitive abuse that Telesis fears. If it is demonstrated in the future that bundling can have competitive or consumer benefits, we may remove our restrictions. (See, e.g., Order Instituting I.93-12-007, slip op. at 30-31; AG's Op., p. 24.) But we will do so in full awareness of the special abilities of AT&T/McCaw to combine services.

We also find that the provisions of Business and Professions Code § 17026.1 are sufficient to meet the concerns of CAA, and no further restrictions are appropriate as conditions on our approval of the application. We note that CAA has alleged that McCaw has violated our prohibition on bundling and the provisions of Business and Professions Code § 17026.1. CAA may pursue its claims of violations of statute and the Commission's orders by filing a complaint under § 1702 and Rule 9 et seq.

5. **Horizontal Implications**

As we have mentioned, for the interexchange market, the merger has a horizontal aspect, since it will combine two companies that are currently engaged in providing interexchange services. AT&T and McCaw compete in the long distance market, and Telesis asserts that the merger of the two will further increase concentration in a market dominated by AT&T. We agree with the AG that adding McCaw's relatively insignificant share of the market to AT&T's leading market share will not have substantial competitive consequences. (AG's Op., pp. 27-28; see Mayo, pp. 26-27.)

6. **Conclusion**

For the reasons stated in the preceding discussions, we conclude that the proposed merger will not have an adverse effect on competition in the interexchange market.

B. **Local Cellular Services**

The market for local cellular services exists in the individual metropolitan service areas (MSAs) and rural service areas (RSAs) where McCaw has its cellular operations.[14] (AG's Op., p. 14; see Mayo, p. 14.) Currently, two wholesale cellular suppliers--one wireline (referring to the local telephone company (Block B)) and one nonwireline (referring to entities not providing local telephone service in the area (Block A))--are licensed for each MSA and RSA,[15] and numerous resellers compete at the retail level in most areas. (See Mayo, Ex. JWM 12.)

14 The FCC awarded cellular licenses in defined urban (MSAs) and rural (RSAs) areas.

15 This neat division is sometimes blurred. Two of Telesis' companies, for example, control (with McCaw as a substantial partner) the Block A license in the San Francisco MSA, even though local telephone service throughout much of this area is primarily provided by Pacific Bell, another Telesis company. GTE Mobilnet was awarded the Block B license.

We are very aware that local cellular markets are not as competitive as we would like, and we have expressed our frustration that despite many earmarks of healthy competition, local markets have not reflected the price decreases that should accompany the maturation of the market. (See Direct Testimony of Lawrence A. Sullivan (Sullivan), p. 17.) However, we believe that the primary reason for the high prices for local cellular service is the structure of the market. Specifically, the existence of only two wholesalers in each MSA or RSA has resulted in high prices despite the existence of numerous retailers. (See, e.g., Order Instituting I.93-12-007, slip op. at 15; D.90-06-025, 36 CPUC 2d 464, 471.) That characteristic of this market will not be affected by the merger.

Changing the ownership of the parent of McCaw's cellular utilities will have no effect on the underlying obstacle to greater competition in local cellular markets--the wholesale duopoly. The merger will improve McCaw's financial position, and the service and infrastructure improvements will enhance the cellular utilities' ability to compete. But overall we think that these effects are relatively minor, and we conclude that the merger will not have an adverse competitive effect on local cellular markets. The influence of the merger on competition in these local markets will be overwhelmed by much more significant changes in the structure of this market, and in particular by the effects of greater competition stimulated by the emergence of new wireless technologies.

In the near future, substantial competition to conventional local cellular service could emerge from at least three technologies. Specialized mobile radio (SMR) uses new technology to open up radio frequencies currently allocated to, e.g., taxicab dispatching, for broader two-way calling. The FCC authorized NEXTel (formerly FleetCall) in 1991 to provide this service. As we have mentioned, the FCC will soon auction off PCS licenses, which are expected to compete directly with conventional cellular communications. Some companies are also developing mobile satellite services to provide global wireless communications. (See Order Instituting I.93-12-007, slip op. at 5-8; Mayo, pp. 14-15.)

We believe that the introduction of competing technologies, particularly PCS and SMR, will soon provide an influx of competition to local cellular markets which will produce the desired effects on prices. In major markets, the FCC's plans call for up to seven wholesalers of PCS, which should provide considerable competitive pressure on prices. (See Mayo, pp. 24-25.)

C. **Regional Cellular Services**

The AG also concludes that a separate market exists for regional cellular services. (See Sunshine Cellular v. Vanguard Cellular Systems, 810 F.Supp. 486, 496 (S.D.N.Y. 1992).) McCaw has been a leader in accumulating cellular licenses in geographic clusters of adjacent MSAs or RSAs. These clusters can cross LATA and state boundaries, and can be effectively expanded through regional alliances with other providers. (See Telesis' Comments, Declaration of Mary B. Cranston, Ex. 2, Maps 2A, 2B, 3A, 3B, 4A, 4B.) This clustering reduces some switching and operational costs. In addition, this regional clustering allows some cellular interexchange calls to use the cellular switched network to bypass the local switched network, thus avoiding certain access and interconnection charges. The AG cites the example of Florida, where McCaw developed a regional cluster of licenses that allowed it to offer regional interexchange calls as local calls billed at a flat rate. (AG's Op., pp. 10-11.) The configuration of these clusters often cross LATA boundaries, so the RBOC cellular companies are prohibited by the MFJ from competing at this level. The AG notes that no other cellular company has created regional clusters coterminous with McCaw's service areas, and "McCaw is currently the only supplier of the appropriately defined multiLATA

Telesis and other competitors to integrate new wireless systems into the extensive public switched network. Presumably, the arrangement that requires AT&T to maintain and reprogram its switches clearly defines AT&T's obligations, and breaches of those obligations would be subject to the usual contractual or equitable remedies. Any anticompetitive actions by AT&T as the switch manufacturer may also be subject to punishment under state and federal antitrust laws. But the type of behavior Telesis fears could be subtle. We warn AT&T that any allegation that it has used its manufacturer's control over central office switches to delay the start of its competitors' wireless and integrated operations will receive our careful scrutiny and, if the allegations are proven, our severest sanctions. Parties who believe that AT&T has engaged in this sort of activity may file petitions in the merger forum investigation that we open today in a companion order.

We are less concerned about Telesis' fear that the merger will allow AT&T to dictate industry standards. The lesson of other battles between competing technical standards in recent years is that customers' preference prevails, and customers have no loyalty to any particular sponsor of the standard. To cite two examples, the enormous resources, market influence, and reputation of Sony Corporation failed to secure customers' acceptance of the Beta videotape system over the more convenient VHS system, and the sponsorship and authority of the United States government failed to persuade its citizens of the superiority of the metric system of measurement. The point of these perhaps trivial examples is that neither AT&T nor any other manufacturer will be able to set standards unless those standards are judged by the customers to be superior to competing standards. We are not persuaded that the merger will alter this principle in the market for wireless equipment. Customers will purchase what they believe is the better equipment to meet their needs, regardless of the identity of the manufacturer. And this market is sufficiently competitive that customers will be able to chose among competing manufacturers' equipment.

We conclude that competitive pressures exerted by a dynamic market, backed by the threat of legal sanctions for any anticompetitive activity, will ensure that the combination of AT&T and McCaw will have no adverse competitive effect on the market for telecommunications equipment.

E. Conclusion

We join the AG in concluding that the merger will not have a significant adverse effect on competition. (AG's Op., p. 30.) Increasing competition in the market for interexchange services and the emergence of several alternatives to cellular service will subject AT&T and McCaw to competitive pressures that will prevent them from exerting market power in the relevant markets. Even greater competitive checks against potential abuses would emerge if the MFJ's restriction on RBOCs' activities in interLATA markets was lifted.

V. Other Criteria

Before we may authorize this merger, § 854(c) requires us to consider and balance seven specified criteria and to find that, on balance, the proposed merger is in the public interest. The statute requires us to consider the effect of the proposed merger on various characteristics of "the resulting public utility." In this case, neither AT&T, McCaw, nor the resulting company is or will be a regulated utility in California. We will fulfill the statute's requirements by considering the effect on the combined AT&T and McCaw, and on McCaw's California utilities.

For the most part, applicants' showing on the criteria of § 854(c) was not controverted. Our discussion will accordingly be brief.

A. Financial Condition

Section 854(c)(1) instructs us to consider whether the proposed merger will "maintain or improve the financial condition of the resulting public utility."

McCaw currently carries a large debt burden. The merger with AT&T will help McCaw reduce its cost of debt to levels comparable to its competitors. AT&T can acquire McCaw while retaining its investment-grade bond rating; this stock-for-stock exchange will not require AT&T to issue new debt. (Chakrin, pp. 3, 10-11; Hooper, p. 29; Motion, pp. 25-26.)

We conclude that the merger will maintain the financial condition of AT&T and will improve the financial condition of McCaw's California subsidiaries.

B. Quality of Service

Under Section 854(c)(2), we are to consider whether the proposed merger will "maintain or improve the quality of service to public utility ratepayers in the state."

In our description of the settlement and in our discussion of net benefits, we listed some of the consumer benefits that will result from the proposed merger. We will not repeat that discussion here.

We conclude that service to McCaw's customers in California will improve after the merger, in part due to the conditions of the settlement.

C. Quality of Management

The third criterion is whether the merger will "maintain or improve the quality of management of the resulting public utility."

The management of McCaw's California utilities will remain intact. Applicants have made commitments that no loss of jobs or replacement of managers will occur due to the merger. (Hooper, p. 39.) McCaw's California utilities will also have a large pool of trained AT&T employees available for hiring as vacancies arise. (Hooper, pp. 29-30; Chakrin, p. 39.)

We conclude that the third criterion is met.

D. Fairness to Employees

Section 854(c)(4) requires us to consider whether the merger will be "fair and reasonable to affected public utility employees, including both union and nonunion employees."

The settlement provides that for at least two years, no net loss of jobs will occur for McCaw's cellular utilities or AT&T's California operations as a result of the merger. For McCaw's cellular operations, there will be no material reduction in salary or job benefits by job classification for two years. Applicants will provide DRA and CACD with reports on employment and compensation before the merger is consummated and for two years thereafter. (Settlement, par. 31.)

Applicants have also represented that no AT&T or McCaw jobs will be lost due to the merger, and no facilities will be closed, and no large-scale relocation of employees will occur. Employees' union or nonunion status will be honored, and employee benefits will be maintained. Working conditions for McCaw's California employees will be maintained. (Chakrin, pp. 40-41; Hooper, p. 30.)

We conclude that the merger will be fair to affected utility employees.

E. Fairness to Shareholders

Under Section 854(c)(5), we are to consider whether the proposed merger will be "fair and reasonable to the majority of all affected pubic utility shareholders."

The merger agreement offers McCaw's shareholders a 20% premium over market prices. (Hooper, p. 31.) Although AT&T will have a 9-11% short-term dilution in earnings, that dilution is not expected to affect AT&T's annual earnings growth of around 10%. (Chakrin, p. 41.) The transaction is structured as a tax-free exchange, to the benefit of shareholders of both companies. (Chakrin, p. 11)

We conclude that the proposed merger is fair and reasonable to all affected shareholders.

F. Benefits to State and Local Economies

We are also to consider whether the merger is beneficial "on an overall basis to state and local economies and to the communities in the area served by the affected utilities." (Section 845(c)(6).)

The proposed merger will benefit California and its economy by improving the mobile communications infrastructure. The merged company will invest at least $32.5 million in the California utilities' systems over the next two years to upgrade the systems. The systems will be converted to digital technology. As a more effective competitor, AT&T/McCaw will put pressure on other cellular companies to improve their services. (Chakrin, p. 43.) As the company grows in California, it will expand its workforce in the areas served by McCaw's California utilities, to the benefit of the local communities and the local and state economy. (Hooper, p. 32.)

The settlement provides that AT&T's systems and expertise will be used to assure that McCaw's cellular utilities comply with the Commission's orders concerning the WMDVBE program. (Settlement, par. 34.)

We are persuaded that the proposed merger will benefit the local and state economies and the communities served by McCaw.

G. Preserve the Commission's Jurisdiction and Ability To Regulate

Finally, § 854(c)(7) instructs us to consider whether the proposed merger will "preserve the jurisdiction of the commission and the capacity of the commission to effectively regulate and audit public utility operations in the state."

The affected McCaw utilities will remain under our jurisdiction. We also currently regulate AT&T-C, a subsidiary of AT&T. Nothing in the merger will change our ability to regulate or affect our jurisdiction. We note that the PU Code gives us broad power to obtain the information needed to regulate public utilities, even those that are affiliated with large unregulated entities (§ 581 et seq., § 797.)

The settlement includes several provisions designed to meet DRA's concerns about the potential for cross-subsidization. AT&T will treat McCaw as a separate entity for two years, and reports reflecting that status will be provided to the Commission. The cellular utilities will remain as separate entities for at least two years. Any consolidation or merger after that time will be presented to the Commission for its approval under PU Code § 851. (Settlement, par 20, 21.)

In addition to the reports routinely required of public utilities, the merged utility will provide various reports to DRA and CACD for five years. (Settlement, par. 22, 23, App. A.) The reports may be submitted in confidence, but other parties may get access to any such reports by signing an acceptable nondisclosure agreement.

Allocation of corporate overhead to McCaw's cellular utilities will comply with the current allocation practices of AT&T-C. (Settlement, par. 22.)

Applicants also agree to comply with any rules the FCC adopts governing the disclosure of customer proprietary information and applying to nonwireline cellular carriers like McCaw. (Settlement, par. 26.) Applicants will comply with the current provisions of the PU Code and with the Commission's decisions prohibiting the bundling of cellular services or equipment with long distance services or the bundling of a tariffed service with an unregulated service. (Settlement, par. 27.)